IT 05-0002-PLR 03/29/2005 ALTERNATIVE APPORTIONMENT

Private Letter Ruling: Petition for to use alternative apportionment formula granted to taxpayer whose business activity in Illinois would not be fairly reflected in the sales factor.

March 29, 2005

Dear:

This is in response to your letters dated June 10, 2004, and September 8, 2004, in which you request a Private Letter Ruling on behalf of COMPANY1 and its subsidiaries ("COMPANY1"). The Private Letter Ruling will bind the Department only with respect to COMPANY1 for the issue or issues presented in this ruling.

The facts and analysis as you have presented them in your letter dated June 10, 2004, are as follows:

> COMPANY1 ("COMPANY1"), the taxpayer, is writing to petition for alternative allocation or apportionment. The taxpayer is requesting permission to use a separate accounting method in calculating the apportionment factor for the tax year ending December 31, 2003. The separate accounting method on the enclosed schedules will more clearly and accurately apportion income to Illinois based upon business activity within Illinois.
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> In July 2003, COMPANY1 petitioned for use of a separate accounting method in the calculation of the apportionment factor for the 1998 and 1999 tax years on the ground that the standard apportionment method did not fairly represent the extent of its business activity in the State during those years. A copy of the petition is enclosed as Exhibit A to the petition here. In November 2003, COMPANY1 and the Department of Revenue ("Department") entered into an agreement where the Department granted COMPANY1's petition, allowing COMPANY1 to use the separate accounting method for the 1998, 1999, 2000 and 2001 tax years. A copy of that agreement is enclosed as Exhibit B to this petition.
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> There have been no material changes in any of the relevant facts, and no change in the controlling law underlying the petition the Department granted last year. Therefore, for the same reasons the Department approved COMPANY1's prior petition, the Department should approve the petition here.

Your letter dated September 8, 2004, contains an amended return with a petition for the taxable year ending December 31, 2002, as required by 86 Ill. Admin. Code Section 100.3390(e)(2). In that letter, you stated:

> In December 1997, COMPANY2 (COMPANY2) and COMPANY3 Incorporated combined to form COMPANY1, with COMPANY2 and COMPANY3's subsidiary, COMPANY4 (COMPANY4) becoming wholly-owned COMPANY1 subsidiaries. COMPANY1 is a public utility holding company registered under the federal Public Utility Holding Company Act of 1935, and does not own or operate any significant assets other than the stock of its subsidiaries.

COMPANY2 and COMPANY4 are COMPANY1's primary operating subsidiaries. Through COMPANY2 and COMPANY4, COMPANY1 is engaged principally in the generation, transmission, and distribution of electric energy, and the purchase, transportation, distribution and sale of natural gas. Through these two companies, COMPANY1 markets electricity at retail to residential, commercial, and industrial customers, and at wholesale to utilities, power marketers, and other energy providers.

COMPANY2 is the largest electric utility in the State of STATE and supplies electric power in territories in STATE and Illinois having an estimated population of 2,600,000 within an area of approximately 24,500 square miles. COMPANY4 supplies electricity to territories in XXXXX and XXXXX Illinois having an estimated population of 820,000 within an area of approximately 20,000 square miles.

COMPANY1 operates its transmission system as a single, integrated, COMPANY1-wide "control area" – *i.e.,* an electric system with a common automatic generation control scheme that matches the power output of the system's generators with the amount of power required at a point within the system, under a single Federal Energy Regulatory Commission (FERC) tariff. COMPANY1 generates electric power under the "joint dispatch agreement" (approved by the FERC, the STATE Public Service Commission, and the Illinois Commerce Commission) between COMPANY2 and COMPANY4.

The joint dispatch agreement enables COMPANY1 to dispatch, or use, the most cost efficient plants of COMPANY2 and COMPANY4 to serve customers – in either company's actual service territory – within the COMPANY1-wide control area. Thus, via "system energy transfers," COMPANY4 may supply its customers in Illinois with power generated at COMPANY2 facilities in STATE, and COMPANY2 may supply its customers in STATE with electricity generated at COMPANY4 plants in Illinois.

COMPANY1 petitions for use of a separate accounting method in calculating the apportionment factor on grounds that the standard method assigns a disproportionate amount of income to the State and does not fairly represent the extent of the Illinois business activity of COMPANY1 or COMPANY4. The joint dispatch agreement has enabled COMPANY4 to supply customers in its service territory with power generated at COMPANY1's more modern, efficient plants in STATE (*e.g.,* the generating stations operated by COMPANY2). As a consequence, the level of COMPANY4 primary income-producing activity in Illinois, the generation of electricity, has steadily decreased since the agreement went into effect in January 1998.

Nonetheless, because COMPANY1 now reports its income to Illinois on a combined basis, COMPANY4 pays significantly more in taxes than it did before the joint dispatch agreement went into effect – exactly the opposite of what should happen when the level

> of COMPANY4 income-producing activities in the State has declined. COMPANY1 keeps its books and records in accordance with FERC accounting, and its transactions with affiliates (*e.g.,* COMPANY2 and COMPANY4) are regulated by the Securities and Exchange Commission.

In our telephone conversation of September 28, 2004, you explained that the "separate accounting" method COMPANY1 wishes to apply computes the amount included in the Illinois numerator of the sales factor of each member of the unitary business group for transactions other than sales of tangible personal property using only that member's income producing activities.

Ruling

Section 304(f) of the IITA provides:

> If the allocation and apportionment provisions of subsections (a) through (e) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:
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> (1) Separate accounting;
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> (2) The exclusion of any one or more factors;
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> (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or
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> (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

The documents submitted with your petition for the years 1998 through 2001, and with the two current petitions, show that application of the provisions of Section 304(a) of the IITA would not fairly represent the extent of COMPANY1's business activities within Illinois, while the proposed method would fairly and accurately apportion COMPANY1's business income to Illinois.

Grant of Section 304(f) Petition

The petition of COMPANY1 under Section 304(f) of the IITA to use the alternative apportionment formula described in this ruling is hereby granted, and COMPANY1 may use that apportionment formula for its taxable year ending December 31, 2002, as shown on the amended return that accompanied the petition for that year, and for Illinois Income Tax returns due (including extensions) on or after October 8, 2004, which is 120 days after the June 10, 2004, date the petition was filed.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax